IN THE

Supreme Court of the United States

OCTOBER TERM, 1963.

No. 402

J. I. CASE COMPANY, HARRY G. BARR, JOHN T. BROWN, L. R. CLAUSEN, WM. J. GREDE, E. P. HAMILTON, WM. B. PETERS, AND MARC B. ROJTMAN,

Petitioners,

vs.

CARL H. BORAK, FOR AND ON BEHALF OF HIMSELF AND ALL OF THE OTHER COMMON STOCKHOLDERS OF J. I. CASE COMPANY WHO ARE SIMILARLY SITUATED TO HIM,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF OF PLAINTIFF-RESPONDENT.

ALEX ELSON,
Counsel for Respondent.

ALEX ELSON,
WILLARD J. LASSERS,
AARON S. WOLFF,
11 S. LaSalle Street,
Chicago 3, Illinois,
ARNOLD I. SHURE,
11 S. LaSalle Street,
Chicago 3, Illinois,
BRUNO V. BITKER,
208 E. Wisconsin Avenue,
Milwaukee, Wisconsin,
Attorneys for Respondent.

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STATUTES AND CONSTITUTIONAL PROVISIONS INVOLVED.

Other provisions of the Securities Exchange Act of 1934 and the United States Constitution are pertinent here. They are set forth in the Appendix to this brief.

QUESTION PRESENTED.

There is but a single question properly before this Court. The question stated in the petition (p. 2), joined in by J. I. Case Company ("Case") and the individual defendants, is as follows:

> "Whether Sec. 27 of the Act grants a Federal cause of action for rescission or damages to a corporate stockholder in respect of a consummated merger which was authorized pursuant to the use of a proxy statement alleged to have contained misleading statements violative of § 14(a) of the [Securities Exchange] Act."

Without leave of Court, Case and the individual defendants have filed separate briefs. In each brief defendants inject a second issue contrary to the rules of this Court. This action has substantially extended this brief, and will make the oral argument more difficult for respondent and, we think, less satisfactory to the Court.

The Case brief (Case 2) states under "Questions Presented" as I the issue stated substantially as in the petition above but adds as II:

> "Did the court below err in refusing to apply the Wisconsin security for expenses statute, even if such an action is held to lie?"

The individual defendants (Indiv. 2-3) add the question in different language.

Petitioners did not raise or discuss this second issue in their petition for certiorari (Pet. 8-13).

We believe that the effort to introduce the second issue is a clear violation of the rules of this Court, Rules 23(1)(c) and 40(1)(d).

This Court has routinely rejected similar efforts to add questions. The rule is clear and accordingly we limit citations. Thus, in *Local 1976, United Bro. of Carpenters* v. *N.L.R.B.*, 357 U. S. 93 (1958), the petition raised only questions relating to a hot cargo clause and § 8(b)(4)(A) of the National Labor Relations Act. This Court refused to consider contentions advanced in petitioners' briefs as to the capacity in which a given individual was acting and whether there was substantial evidence to support a Board determination. 357 U. S. at 96.

Mr. Justice Jackson put it strongly in *Irvine* v. *California*, 347 U. S. 128 at 129 (1954), saying:

> "We disapprove the practice of smuggling additional questions into a case after we grant certiorari."

Defendants' departure from the rules poses a difficult tactical problem for respondent. We think that the Wisconsin security for expense statute has no part in the case but if the Court should reach it, our position should be stated. For the foregoing reasons, we have divided our brief into two parts. Part I contains argument germane to the case as we see it. Part II contains argument relating to the issue we think is not before the Court.

A final matter. the Court has set this case for argument on the summary docket, presumably because of the single, narrow issue. The enlarged scope of the case will force respondent to spend some time commenting upon what he considers an irrelevant issue. Thus less time will be available to deal with the question properly at bar and hence the Court will have less opportunity to explore the one issue before it.

For all of these reasons we ask the Court to disregard all portions of petitioners' and respondent's briefs relating to the applicability of the Wisconsin security for expenses statute (and particularly Case 26-33; Indiv. 12; Respondent, Part II).

STATEMENT.

Defendants fail to state the relevant facts, fail to relate accurately and completely the proceedings in the District Court, and set forth matters outside the record in an erroneous and misleading manner. Respondent-plaintiff ("plaintiff") will take up these points in order.[1]

1. The Facts.

This appeal arises on a motion of defendant Case for security for expenses under a Wisconsin statute. The District Court held the statute applicable to count 1 and in part to count 2 of the Third Amended and Supplemental Complaint (the "complaint"). The District Court and

1. As above stated without leave of Court, the defendants who joined in a single petition for certiorari have filed two briefs—one by the corporation, the other by the individual defendants. The Court should know that from the inception of this action until after the decision of the Court of Appeals, both the Company and the individual defendant directors were represented by the same counsel. The defendants Rojtman and Elliott were represented by separate counsel. The positions taken in the courts below by the corporation and all of the individual defendants were identical and only one brief was filed for all defendants in these courts. Not until review was sought in this Court did Case retain independent counsel, and only within the past month claim its interests were in conflict with the individual defendants. The letter from counsel for Case dated February 11, 1964 to the Clerk of the Court requesting separate oral argument provides: "* * * counsel for the Case Company state that an integral part of the Company's argument is the contention that if the complaint states a federal cause of action, the action it states is derivative. If the Court accepts this contention, and the allegations of the complaint should be proved, the individual defendants might be liable to the Case Company. It follows that the interests of the Case Company and the interests of the individual defendants differ substantially and that permission should be granted for the Case Company and the individual defendants to be heard by separate counsel."

the Court of Appeals accepted as the facts the allegations of the complaint. Similarly, on review in this Court, the facts are those set forth in the complaint (R. 179-198).

The District Court summarized the complaint and with "slight embellishment" the Court of Appeals adopted the summary. The summary appears at 317 F. 2d 842-4, 846 and R. 222-225, 228-229. For the convenience of the Court the summary is set forth here.

"Count 1 of the complaint alleges that plaintiff, the owner of 2,000 shares of Case common stock acquired prior to the merger complained of, sues in a representative capacity on behalf of himself and all other common stockholders prior to the merger except those participating in or cognizant of the wrongdoing alleged. In addition to Case, he joins as defendants certain of its directors and former directors, some of whom are also officers and former officers, and the executor of the estate of a deceased director. Defendants who are now directors of Case are sued individually and as directors, the defendant Rojtman is sued individually and as representative of American Tractor Corporation shareholders receiving Case stock as the result of the merger between Case and American Tractor Corporation, and the defendant Beeber is also sued, individually and as representative of holders of certain purchase warrants. In Count 1, the plaintiff alleges substantially as follows: In October 1956, Case formally announced to its shareholders a proposed plan of merger between Case and American Tractor Corporation and proposed stock option amendments, which were purportedly approved by Case shareholders on November 15, 1956. The merger was purportedly consummated on January 10, 1957. Both the merger and stock option plan were effectuated by illegal and fraudulent acts and illegally deprived the plaintiff and other shareholders similarly situated of their preemptive right—rights which the plaintiff here seeks to

enforce. Under the merger and plan, 648,852 shares of common stock and 1,197,704 shares of second preferred stock were set aside or issued without granting the plaintiff's class their pre-emptive rights to subscribe thereto.

"The plaintiff then describes in some detail the acts which he believes to have resulted in a violation of the pre-emptive rights of Case shareholders as follows: In 1954, Elliott's company and a syndicate headed by him acquired 170,000 shares of American Tractor Corporation stock. Elliott violated the Securities Act of 1933 and regulations thereunder in connection with that stock and the sale of a portion thereof. Thereafter, the market price of American Tractor Corporation stock, most of which was held by Elliott, Rojtman and their associates, began an unreasonable rise, due to illegal manipulations, which manipulations Elliott was aware of prior to the merger. Rojtman, Brown, Grede and the Case management also knew prior to the merger that the market price of ATC stock was achieved illegally and artificially. Since the merger one person has been found guilty in another district court of manipulating ATC stock from May, 1955 to February, 1956; and Gilligan, Will and Company, formerly defendant in this cause and the specialist in ATC stock on the American Stock Exchange was found by the Securities and Exchange Commission to have engaged in improper and illegal activities while specialist with respect to ATC stock.

"Case directors violated Wisconsin law and breached their fiduciary duties to the shareholders in approving the merger by including future earnings of American Tractor Corporation and future services of its officials as partial consideration for issuance of Case stock, by agreeing to issue Case stock at less than par value, by failing to evaluate properly the American Tractor Corporation assets acquired and paying an excessive price for American

Tractor Corporation, by over-valuing American Tractor Corporation's and undervaluing Case's earnings and book value resulting in a fraud on Case shareholders, by relying on market price of American Tractor Corporation stock as a measure of American Tractor Corporation's value, by relying on American Tractor Corporation's own appraisal of its physical assets and failing to examine that appraisal, by considering future earnings as an element of value and by failing to recognize the necessity of future investments as part of the cost of the merger.

"Case directors breached their fiduciary duties by approving and issuing a letter and proxy statement of October 15, 1956, prior to the meeting at which the merger was approved which contained numerous material omissions and false and misleading statements relied upon by Case shareholders in approving the merger and without which the merger would not have been approved. Three pages of the complaint are given over to instances thereof.

"For example, it is alleged that defendants failed to disclose that the total purchase price of ATC exceeded $17,000,000, that the book value of Case common stock was $36.00 and ATC's only $1.15, that persons who negotiated the merger were recipients of stock options; and that one of the director defendants, as a supplier, would receive a substantial increase in business as a result of the merger, the merger was fair because in accordance with the comparative market prices of the two stocks, and the Case common shareholders would not be adversely affected when in fact their proportionate interest in the earnings, book value and voting power were seriously diluted.

"Both the Case and American Tractor Corporation management groups were guilty of self dealing in connection with the plan and merger.

"The conduct of the defendants, the plaintiff claims, con-

stitutes actual or constructive fraud on himself and other shareholders similarly situated depriving them of their pre-emptive rights. He claims that if they had been permitted to purchase stock issued in the merger on the same basis as American Tractor Corporation shareholders, they could have obtained one-fourth share of common stock and one-half share of second preferred stock for $2.20 for each share of Case common stock held by them at the time of the merger.

"In Paragraph 19 of Count 1 of his complaint, the plaintiff alleges facts occurring after the merger particularly, that Brown, Grede, Rojtman and other principal defendants were no longer with Case and that Case was nearly bankrupt; in Paragraph 20 he alleges that the class he represents has been irreparably damaged by failure to recognize pre-emptive rights, and in his prayer for relief he asks that the court enter judgment in favor of the class he represents and against Case directors who approved the merger and all defendants the court finds responsible for the merger and the consequent deprivation of pre-emptive rights in an amount to be determined and/or that the court enter a decree directing Case to issue to the class he represents such securities of Case as the court deems necessary to compensate the class for violation of pre-emptive rights, and asks for such other relief as equity shall require.

* * *

"* * * As the jurisdiction basis for count 2, plaintiff asserted diversity of citizenship between the parties, Section 27 of the Securities Exchange Act and Sections 1331 and 1337 of the Judicial Code. 28 U. S. C. A. 1331, 1337.

"By reference, plaintiff realleged substantially all of the charging paragraphs contained in count 1 of the complaint. He alleged that the merger between Case and ATC was

consummated early in 1957, following its approval by a vote of two-thirds of the outstanding common and preferred shares of Case at a special stockholders meeting held for that purpose. The count alleged that the proxy solicitation material issued by the defendants prior to that special meeting was false and misleading and its use constituted a violation of Section 14(a) of the Act and the SEC Rules promulgated thereunder. 17 CFR 240.14a-3, 140.14a-9. The theory of the cause of action stated in that count was the contention that the Case-ATC merger and stock option agreements approved by the vote of proxies given by shareholders of Case in response to allegedly unlawful proxy solicitation material were void agreements under the provisions of Section 29(b) of the Act. 15 U. S. C. A. 78cc(b). Plaintiffs sought relief declaring that the proxy solicitation material was false and misleading, that the proxies solicited thereby were illegal and void, and that the merger and all agreements entered into pursuant thereto were void. He also prayed damages for injuries sustained by himself and all other stockholders similarly situated which grew out of violation of the Act, and such other and further relief as equity might require.'"

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1. Defendants not only ignore these facts but go beyond the record to make statements of a misleading character. For brevity, we refer to only three of such statements:

(1) Defendants state that the merger has proven "beneficial" (Indiv. 5). The statement is in direct contradiction to the record which shows the merger has proven disastrous. The complaint states: (a) at the time of the merger ATC "was scarcely a viable entity"; (b) that in 1958, as a result of the merger, Case had to issue debentures of $25,000,000; (c) that in 1960 and 1961 Case obtained short term bank loan extensions of $178,000,000 and $162,000,000 (and for 1 and 3 years) respectively, and that but for the extensions, Case would be in bankruptcy, receivership or reorganization; (d) that in the year ending October 31, 1960, Case had a net loss of $39,814,793 and that in the first 9 months of fiscal 1961 Case had a net loss of $7,121,308, which losses exceeded the accumulated earnings of $42,932,616 at the time of the merger; (e) as a result of these losses Case stopped dividend payments on its first preferred stock in 1961, dividends which

2. History of Litigation.

Defendants have sought, for over seven years of litigation, to delay trial and to avoid it altogether if possible. Defendants give an incomplete history of the proceedings below which leaves the unwarranted impression that the long delays are due primarily, if not solely, to plaintiff's filing of amended complaints to avoid application of the Wisconsin statute (Case 6; Indiv. 4). Although the history is not directly relevant, it does place the issues in perspective. It ought to be set forth accurately. The chief steps were as follows:

(1) *The complaint—attempts at injunctive relief—*

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had been paid continuously since 1935; and (f) in 1961 Case abandoned production of crawler tractors at the plant in Churubusco, Indiana, the only plant facility acquired from ATC (R. 189, 195). The record also shows that by 1960 and 1961 the individual defendants in management had "resigned" (R. 194-195) and the Company has made clear it does not want to be associated with its co-defendants (Case 9).

(2) Apparently to support the position that the merger was beneficial, defendants state that no other stockholder has joined with the plaintiff or challenged the legality of the merger in any other proceeding (Case 5). This statement is untrue. In 1957 defendants procured dismissal of an action brought against them by other shareholders in relation to the merger in New York on the ground of *forum non conveniens*. *Novich, et al.* v. *Rojtman, et al.*, 5 Misc. 2d 1029, 161 N. Y. S. 2d 817 (1957).

(3) Defendants quote the market price of Case common stock on the New York Stock Exchange for a period of three years following the merger when the price "rose steadily" (Case 21, App. D. p. 43). This statement is outside the record and misleading. Since defendants have presented part of the story, the Court should have the whole story of stock market prices. Subsequent to 1959 the market price plummeted:

	Low*	High
1960	7½	22⅛
1961	6¾	13¼
1962	4½	9⅝

Beginning in the latter part of 1962 with a complete change of management and almost a complete new board of directors, Case began to make a profit and stock market prices reflected this change.

* Source: Standard & Poor's stock guide.

early efforts of defendants to avoid merits—discovery by plaintiff (November 1956 to March 1958). On November 13, 1956, plaintiff, holder of 2,000 common shares of Case, filed a representative (non-derivative) complaint to declare void and to enjoin the merger between Case and ATC (R. 15, 16). He alleged, *inter alia*, that the proxy statement was false and misleading (R. 6-8, 15).[1]

On November 15, 1956, the District Court denied a motion for a temporary injunction (R. 86). On that day the stockholders approved the merger by a "close margin" (R. 192) of only 3.70% votes more than the minimum required.[2]

On November 26, 1956 defendants answered, denying that the "Proxy Statement * * * is untrue or misleading" (R. 79, 81). They raised no affirmative legal defenses. At the same time defendants sought an immediate trial and an order precluding all pre-trial discovery (R. 82-85). Plaintiff opposed the motion but urged early trial (R. 92-3). Defendants agreed to produce some documents (Unprinted R. 134-6) but since December, 1956 have sought to frustrate discovery (see, e.g., Unprinted R. 134-6, 147-154, 176, 206-209, 231-237, 295-7, 315-19).

In addition defendants by a series of motions sought to

1. Defendants conceded in the Court of Appeals that the original complaint was not derivative and not subject to the Wisconsin statute (Def. Br. Ct. App. 24). Had defendants made this concession at any time in the District Court, we think that court also would have held the subsequent complaints to be non-derivative.

2. Shareholder approval of the merger by 66⅔% of the outstanding shares was required. The plan achieved only 1,592,474 votes out of 2,262,766 shares outstanding or a favorable vote of 70.37%. Defendant's statement (Case 6) that of the common shares voting at the stockholders' meeting, 91.8% voted in favor of the merger is misleading. The test is not the percentage of those voting, but of shares outstanding. Moreover, this statement tends to create the erroneous impression that the outcome of the vote would have been the same even if the proxy statement had not been misleading (R. 106).

avoid trial completely. These included motions (1) for summary judgment, denied March 6, 1957 (Unprinted R. 142, 174); (2) to dismiss, filed April 22, 1957 and withdrawn May 13, 1957 (Unprinted R. 190, 241); (3) to dismiss and for judgment on the pleadings, filed September 20, 1957 and ordered deferred until plaintiff completed discovery and filed his amended complaint (Unprinted R. 264, 288).

During the course of defendants' obstructionist tactics and from December 1956 until March 1958, plaintiff's counsel spent more than 3100 hours in discovery and trial preparation; made three extended trips to New York City, Washington, D. C. and innumerable trips to Milwaukee; examined 34 deponents whose testimony exceeds 3,700 pages and examined thousands of pages of documents; all at considerable expense to plaintiff (Unprinted R. 541-4).

(2) *Amended complaint—first motion for security—(April 1958-July 1960).*

On April 1, 1958 plaintiff filed his amended complaint (R. 111). Although the amended complaint did not differ materially from the original complaint, defendants, on April 7, 1958, a year and a half after the institution of the action, for the first time moved for security under the Wisconsin security for expense statute, requesting security of $1,000,000 (Unprinted R. 373).

The District Court on October 23, 1958 ordered plaintiff to post security of $75,000 but granted leave to amend (R. 151).

Plaintiff's motion for rehearing, filed December 2, 1958, was denied and the action was dismissed for failure to post security on September 17, 1959 (R. 157). On March 10, 1960, however, the court vacated its dismissal and granted leave to plaintiff to file a second amended and supplemental complaint (R. 158). Defendants appealed from the order

allowing the amended complaint, but the appeal was dismissed by the Court of Appeals on April 21, 1960, for want of jurisdiction (Unprinted R. 619).

(3) *Second amended complaint—second motion for security. (July 1960-January 1962).*

Case renewed its motion for security on July 19, 1960 (Unprinted R. 647),[1] and on January 2, 1962 the District Court ordered plaintiff to file another complaint separating his "cause of action" based on diversity of citizenship from his "cause of action" arising under the Act (Unprinted R. 671-2).

(4) *Third amended complaint—third motion for security (January 1962-October 1962).*

Accordingly, on January 12, 1962 plaintiff filed his third amended and supplemental complaint. Case renewed its motion for security on January 26, 1962 (R. 198) and on September 4, 1962 the District Court made its ruling.

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1. Defendants' irrelevant assertion (Case 7) that they were not put on notice of plaintiff's claim under § 14(a) until July, 1960 (Case 7) is not well founded. As they recognize (Case 5), the original complaint alleged the proxy statement was false and misleading and asked the court to declare that the merger was void (R. 15-16). Indeed, the answer denied that the proxy statement was misleading (R. 79, 81).

Defendants filed also a series of motions again obviously designed to delay or avoid trial including motions to quash service or process (Unprinted R. 663, 665, .668) and plainly inconsistent motions to dismiss because the complaint allegedly did not state "a short and plain" claim under Rule 8, F.R.C.P. and in the alternative for a more definite statement of the claim (Unprinted R. 652). Individual defendants suggest also they will raise certain affirmative defenses such as failure of the complaint to allege that securities of Case are registered on a national exchange (Indiv. 5, note 1). In grasping for straws, defendants overlook that the proxy statement, incorporated in the complaint by reference (R. 182), states that Case securities are listed on the New York Stock Exchange (R. 24, 27, 42). They overlook also the Company's brief which states that Case stock was listed on the New York Stock Exchange (Case 4).

3. The Rulings Below.

The District Court held (R. 200) that count 1 stated a derivative action as to which the Wisconsin statute was applicable (R. 208). As to count 2, the court, following *Dann* v. *Studebaker-Packard Corp.*, 288 F. 2d 201 (C. A. 6, 1961), held that federal jurisdiction under § 14(a) of the Act ended with the grant of declaratory relief (R. 211). The District Court recognized that here, unlike *Dann*, there was diversity and hence power to grant plenary relief. The court concluded, however, that such relief could be granted only under state law and hence the Wisconsin statute applied in part to count 2 (R. 212). The court therefore ordered plaintiff to post security of $75,000 with leave to file an amended complaint alleging only the § 14(a) cause of action for a declaratory judgment that the proxies were invalid and the merger void (R. 213). The District Court made the certificate required by § 1292(b) of the Judicial Code and the Court of Appeals granted leave to appeal (R. 215, 216).

The Court of Appeals reversed the district court. It held that count 1 stated a claim on behalf of stockholders individually and that the Wisconsin statute was therefore inapplicable (317 F. 2d at 845; R. 227). With respect to count 2, the court held that under §§ 14(a) and 27 of the Act federal courts are clothed with power broad enough to effectively protect "the right of shareholders to a full and fair disclosure of all material facts which affect corporate elections by proxy" including "damages or such other retrospective relief * * * as the merits of the controversy may require" (317 F. 2d at 848, 849; R. 233, 234). The court held also that the Wisconsin statute is inapplicable to count 2 (317 F. 2d at 849; R. 234).[1]

1. The Court of Appeals agreed with the district court that § 10(b) of the Act was inapposite here (317 F. 2d at 846; R. 229). That issue is not before this Court.

Defendants have not sought review of the Court of Appeals decision that count 1 is not derivative, and that the Wisconsin statute is inapplicable to it. Review is limited solely to count 2 (Case 33; Indiv. 13).

SUMMARY OF ARGUMENT

For over seven years the defendants have successfully resisted trial on the merits. The motion for security for expenses which gave rise to the order of the District Court, reversed by the Court of Appeals, was designed to discourage the plaintiff altogether. In essence, the complaint charges a deprivation of preemptive rights of plaintiff and other shareholders, the result of a merger approved by means of a false and misleading proxy statement, and in consequence of illegal and fraudulent conduct on the part of directors and others. Count 1, based on diversity jurisdiction, claims breach of the directors' fiduciary duty to the shareholders. The Court of Appeals held the Wisconsin Security for Expenses statute inapplicable to this count, and no review is sought in this Court of that holding. Review in this case is limited to count 2. This count, based on diversity and federal question jurisdiction, claims that shareholders' rights were violated by the approval of the merger through a false and misleading proxy statement, which contravened § 14(a) of the Securities Exchange Act of 1934 (the "Act").

The sole issue before this Court is the scope of relief which a federal court has jurisdiction to grant in a private cause of action brought under §§ 14(a), 27 and 29(b) of the Act. The Court of Appeals held that the District Court has jurisdiction to award damages or such other retrospective relief as the merits of the controversy may require.

The Court of Appeals decision is correct and consistent with a long line of authority. The existence of a private right of action has been recognized by every circuit which

has considered the question. With the exception of *Dann v. Studebaker-Packard Corp.*, 288 F. 2d 201 (C. A. 6, 1961), the right of the plaintiff to appropriate relief has never been questioned. A private right of action for violation of proxy rules with jurisdiction and discretion to grant full relief is required both by the purpose and design of the Act. It is necessary to give shareholders the full measure of protection which Congress provided for them. Their losses can be recovered most effectively through a private action in which the violators will be required to make the victims whole. Such a private action is consistent with a statute designed to eliminate false and misleading proxy statements and which envisages "reasonably complete and effective" regulation (Act, § 2).

The District Court held there was a private cause of action for violation of § 14(a) of the Act but that the sole relief it had jurisdiction to grant was to enter a declaratory judgment that the proxy statement and merger and all agreements made pursuant thereto were void, and that the plaintiff would thereafter have to secure enforcement of the judgment in the state courts.

All the defendants here concede there is a private cause of action under § 14(a) but disagree as to the scope of relief. Defendant Case claims that jurisdiction extends only to the entry of an injunction (Case 10). The individual defendants go further and concede the court may enter a declaratory judgment as to the validity of the proxies (Indiv. 10).

In addition to attacking the decision of the Court of Appeals, defendants also attack the order of the District Court which they here seek to have reinstated, by the claim that a declaratory judgment cannot be entered as to the legality of the merger agreement. Defendants have offered no sound reasons for disturbing the Court of Appeals de-

cision. They concede the correctness of the cases granting full relief under § 10(b) of the Act but make no effort to show why a different rule should apply to § 14(a) cases. Despite their concession and the District Court ruling that a cause of action will lie under § 14(a) for some relief, they rely inconsistently on cases under other statutes holding that a private cause of action will not lie for any relief. For the same reason their argument on the *expressio unius* maxim is illogical. It also has been rejected specifically as to the issue before the Court by lower federal courts and by implication in this Court. The split or piecemeal litigation device suggested by the *Dann* case, relied on by the District Court and the defendants has been the subject of widespread criticism. It would defeat the purposes of the Act and make a mockery of the federal judicial process.

The question of the applicability of the Wisconsin Security for Expenses statute was not raised or discussed in the petition for certiorari and is not properly before this Court. The argument on this question should be disregarded. If the Court should consider the issue, our position on the merits is summarized as follows:

1. The Wisconsin Security for Expenses statute applies only to actions brought in the right of the corporation. This action is brought on behalf of shareholders in their own right. Even if count 2 stated a derivative claim, the claim arises from and is bottomed on federal law, and every court considering the question has accordingly held security for expenses statutes inapplicable.

2. The Wisconsin Security for Expenses statute, if applicable, violates the due process and equal protection clauses of the Fourteenth Amendment of the United States Constitution. The Wisconsin Security for Expenses statute is significantly different from the New Jersey security

for expenses statute which has previously been upheld by this Court. Under the Wisconsin statute, the plaintiff must be the holder of 3% of the common stock of Case or own 67,883 shares valued at $1,358,000 in order to maintain a derivative suit without posting security. Under the New Jersey statute, shareholders are exempt if they own 5% of the stock or stock having a market value of $50,000. The Wisconsin statute arbitrarily and unreasonably closes the courts to derivative suits brought by shareholders of publicly held Wisconsin corporations generally and Case particularly, regardless of whether the action is well founded or the shareholder has a substantial financial interest in the corporation.

Even though there may be common law state remedies, their ineffectiveness or inadequacy in practice support the recognition of an effective private cause of action for false and misleading proxy statements.

Fifth. The absence of any formal administrative procedure under the Act requires the recognition of a private right of action. Many practical considerations may dictate policy on the part of the Commission to initiate judicial action having no significance to the merits of the matter. Lack of information, limitations of time, manpower and resources are among such considerations. The inaction by the Commission should not in these circumstances bar an action to secure compliance with the proxy rules by interested and affected shareholders.

Sixth. A civil remedy may clearly be implied from section 29(b) providing that every contract made in violation of the Act or whose performance would involve a violation is void. Support for this position is found in the 1938 amendment to the Act, providing that certain contracts should not be deemed void in any action maintained in reliance upon this subsection (48 Stat. 903 (1934) as amended, 52 Stat. 1076 (1938), 15 U.S.C. 78 cc (b) (1958)). In *Goldstein v. Groesbeck supra*, 142 F. 2d 422, the late Judge Charles Clark analogized the provision of section 26(b) of the Public Utility Holding Act (15 U.S.C.A. § 79z(b)), to section 29 of the 1934 Act.

He said (*Ibid* at 426-7):

> "* * * § 26 is incomplete, if not ineffective, unless it is considered to authorize recovery by the operating companies. The rule of damages—whether return of the full consideration, as plaintiff claims, or only the difference between the consideration and the value of the services received—need not be settled now in advance of answer and of trial on the merits. A useful analogy in favor of this interpretation can be found

in § 29 of the Securities Exchange Act of 1934, 15 U. S. C. A. § 78cc, which is virtually identical with § 26 of the Utility Act, for it is now clear from the 1938 amendment to § 29, 52 Stat. 1076, that Congress intended a right of recovery thereunder. *Geismar* v. *Bond & Goodwin, Inc.*, D.C.S.D.N.Y., 40 F. Supp. 876."

Seventh. Section 27 of the Act does not distinguish between actions brought by the Commission and actions brought by private persons.

> "Once a private plaintiff is properly in court under the proxy rules there is no reason to suppose that the quantum of relief which a court of equity may grant is any different from what it would if the Commission were the plaintiff." Loss, Securities Regulation (2d Ed. 1961), p. 956.

In actions where the Commission was plaintiff, courts have appointed receivers under the 1934 Act, even though such relief is not provided for expressly since a court of equity has inherent power to provide complete relief in the light of statutory purposes.[1]

The foregoing considerations have been articulated and relied upon by the solid array of authority referred to by the Court of Appeals below. We turn now to defendants' briefs.

5. The briefs of defendants are of interest more for what is conceded and by their significant silences than for what is expressly asserted. As noted, all defendants concede the existence of a private cause of action under section 27 for violations of section 14(a). (Case 10; Indiv. 9). There is no discussion and in fact no effort to deal with

1. *S. E. C.* v. *Los Angeles Trust Deed & M. Exchange*, 186 F. Supp. 830 (S. D. Cal.), *modified and affirmed*, 285 F. 2d 162 (C. A. 9, 1960), *cert. denied* 366 U. S. 919 (1961); *S. E. C.* v. *H. S. Simmons & Co., Inc.*, 190 F. Supp. 432 (S. D. N. Y. 1961). See also *Aldred Investment Trust* v. *S. E. C.*, 151 F. 2d 254 (C. A. 7, 1945), *cert. denied*, 326 U. S. 795 (1946) (Granted receivership under Investment Company Act of 1940, relief not specified in the statute).

ARGUMENT.

I.

THE COURT OF APPEALS CORRECTLY HELD THAT THERE IS JURISDICTION UNDER SECTION 27 OF THE SECURITIES EXCHANGE ACT OF 1934 TO GRANT DAMAGES OR OTHER RETROSPECTIVE RELIEF IN A SHAREHOLDER'S SUIT FOR VIOLATION OF SECTION 14(a) THEREOF.

1. The sole issue before this Court is the scope of relief a federal court has jurisdiction to grant in a private cause of action brought under sections 14(a), 27, and 29(b) of the Securities Exchange Act of 1934 (the "Act"). The Court of Appeals held that the District Court has jurisdiction "to award damages or such other retrospective relief to the plaintiff as the merits of the controversy may require" (317 F. 2d at 849; R. 234).

The District Court held there was a private cause of action for violation of section 14(a) of the Act but that its jurisdiction was limited to entering a declaratory judgment that the proxy statement was false and misleading in material respects, that the proxies solicited were illegal and void under section 14(a) and that the merger and all agreements made pursuant thereto are void under section 29(b) of the Act for violation of section 14(a) (R. 215). The defendants did not file a cross-appeal from this order. In the Court of Appeals they conceded that the District Court had jurisdiction to declare the proxies invalid and notwithstanding their request that the District Court order be upheld, attacked that part of the order which held that the court had jurisdiction to grant a declaratory judgment that the merger and all agreements

made pursuant thereto are void (Br. for Def., Ct. of App. pp. 36, 41).

All the defendants here concede there is a private cause of action under § 14(a) but disagree as to the scope of relief. Defendant Case claims that jurisdiction extends only to the entry of an injunction (Case 10). The individual defendants go further and concede the court may enter a declaratory judgment as to the validity of the proxies (Indiv. 10). Although the defendants differ with each other as to the scope of relief, they are at war as to this issue not only with the Court of Appeals but with the District Court whose order they seek to have reinstated (Case 33; Indiv. 13).

2. The provisions of the Act and rules relevant to the issue of scope of relief are sections 2, 14(a), 27 and 29(b) (15 USCA 78(b), (n)a, (aa), (cc)b, and rules 14a-3 and 14a-9 thereunder (17 CFR 240.14A-3, 14A-9).

Section 2 of the Act sets forth in detail the necessity for regulation. Section 14(a) prohibits solicitation of proxies for securities listed on national securities exchanges in violation of the rules and regulations of the Securities and Exchange Commission ("Commission") promulgated thereunder. Rule 14a-3 makes a condition of the solicitation of proxies that the person solicited be furnished with a written proxy statement containing certain specified information. Rule 14a-9 prohibits the use of false and misleading statements with respect to any material fact or the omission of any material fact which would render any statement contained in the proxy solicitation false and misleading.

Section 27 of the Act vests in the United States District Courts exclusive jurisdiction of violations of the Act and the Commission's rules promulgated thereunder, in all suits in equity and actions at law brought to enforce any

liability or duty created by the Act or rules, provides for nationwide service of process, sets forth venue provisions with respect to such actions and for the review of judgments as provided by sections 225 to 347 of the Judicial Code (28 U. S. C. A. §§ 1254, 1291-4).

Section 29(b) of the Act provides that contracts are void if made in violation of the Act or rules, or if performance of the contracts involve a violation or a continuance of any relationship or practice in violation thereof. Such contracts are made void as to the rights of persons who in violation of the Act or rules have made or engaged in the performance of such contract, or who have acquired rights under such a contract with knowledge of the facts.

3. The Court of Appeals concluded that the District Court had jurisdiction to award damages or such other retrospective relief as the merits require.[1] The basis for this holding is that the obvious purpose of section 14(a) is the protection of the rights of shareholders by a full and fair disclosure of all material facts which affect corporate elections by proxy; and that the jurisdiction conferred by section 27 is broad enough to encompass a civil remedy to shareholders fully effective to protect

1. In view of the District Court's holding, not challenged by the defendants, that a private right of action may flow from violation of Section 14(a), it was unnecessary for the Court of Appeals to consider this question. The private right of action is well established: *Dann* v. *Studebaker-Packard Corp.*, 288 F. 2d 201 (C. A. 6, 1961); *Central Foundry Co.* v. *Gondelman*, 166 F. Supp. 429 (S. D. N. Y., 1958); *Rosen* v. *Alleghany Corp.*, 133 F. Supp. 858 (S. D. N. Y., 1955); *Horwitz* v. *Balaban*, 112 F. Supp. 99 (S. D. N. Y., 1949); *Tate* v. *Sonotone*, 5 S. E. C. Jud. Dec. 310 (S.D.N.Y., 1947). See also, *Mack* v. *Mishkin*, 172 F Supp. 885, 889 (S. D. N. Y., 1959); *Textron* v. *American Woolen Co.*, 122 F. Supp. 305, 308 (D. Mass., 1954). And see *Brown* v. *Bullock*, 194 F. Supp. 207, 231 (S. D. N. Y., 1961), *affirmed on other grounds*, 294 F. 2d 415 (C. A. 2d), and *Phillips* v. *United Corp.*, 5 S. E. C. Jud. Dec. 445 (S. D. N. Y., 1947), where violations of the same proxy rules, made applicable by other provisions of the federal securities laws, were involved.

that right. The Court of Appeals relied primarily on *Bell* v. *Hood*, 327 U. S. 678 (1946), which held that federal courts have the power under a general grant of federal jurisdiction to grant all the relief commensurate with the effective enforcement of the statute and protection of rights created thereby, even if the statute does not specify the remedies that may be applied. The Court of Appeals also cited as authority, some of the cases arising under section 10(b) of the Act construing the jurisdictional grant under section 27 as including the power to award damages and other retrospective relief. *Ellis* v. *Carter*, 291 F. 2d 270 (C. A. 9, 1961); *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C. A. 5, 1960), *cert. denied* 365 U.S. 814; *Smith* v. *Bear*, 237 F. 2d 79 (C. A. 2, 1956); *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (C. A. 2, 1951); *Kohler* v. *Kohler Co.*, 208 F. Supp. 808, 820 (E. D. Wis. 1962). The Court referred to two cases in which the same holding was made with respect to the cases arising under section 14(a). *S. E. C.* v. *Transamerica Corp.*, 163 F. 2d 511, 518 (C. A. 3, 1947), *cert. denied* 332 U. S. 847; *Mack* v. *Mishkin*, 172 F. Supp. 885, 889 (S. D. N. Y., 1959). The Court also cited *Deckert* v. *Independence Shares Corp.*, 311 U. S. 282 (1940).

In that case this Court had occasion to construe and apply Section 22 (a) of the Securities Act of 1933 which like Section 27 of the 1934 Act gave specified courts jurisdiction "of all suits in equity and actions at law brought *to enforce* any liability or duty created by" the act. (Emphasis supplied.) The Court had before it the question whether the Securities Act of 1933 authorizes purchasers of securities to maintain a suit to rescind a fraudulent sale and secure restitution of the consideration paid, and to enforce the right to restitution against a third party when the vendor is insolvent and the third party has assets in its possession belonging to the vendor.

Section 12(2) of the 1933 Act makes fraudulent sellers of securities liable to their buyers for rescission or damages. The Court upheld the right to maintain such an action. The following language from the opinion (p. 288) is particularly significant to this case:

> "* * *in § 22 (a), 15 USCA § 77V, specified courts are given jurisdiction 'of all suits in equity and actions at law brought *to enforce* any liability or duty created by this sub-chapter.' The power to *enforce* implies the power to make effective the right of recovery afforded by the Act. And the power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case."

Finally, the Court of Appeals relied on the construction placed by the courts on other federal statutes which include a general grant of jurisdiction to the district courts such as the Investment Company Act of 1940 (15 U.S.C.A. 80a-35), *Aldred Investment Trust* v. *SEC.*, 151 F. 2d 254, 261 (C. A. 1, 1945), cert. denied 326 U. S. 795 (1946); Emergency Price Control Act of 1942 (50 App. U.S.C.A. 925(a)); *Porter* v. *Warner Holding Company*, 328 U. S. 395 (1946); Fair Labor Standards Act of 1938 (29 U.S.C.A. 215(a), 217); *Mitchell* v. *Robert DeMario Jewelry Inc.*, 361 U. S. 288, 291 (1960); and the Sherman Act (15 U.S.C.A. 1, 2), *Schine Chain Theatres, Inc.* v. *United States*, 334 U. S. 110 (1948).

4. The opinion of the Court of Appeals below was manifestly sound, but since the character of the remedy afforded by section 27 is before this Court for the first time, some further elaboration may be warranted.

The federal courts have power "to grant all of the relief which may be commensurate with the effective enforcement of the statute and the protection of rights

created thereby, notwithstanding the failure of the statute to specify the remedies which may be employed." *Bell* v. *Hood*, 327 U. S. 678, 684 (1946). The reasons for implying an action and for granting full relief are inseparable.

First. Private remedies are implied where the statute is a broadly based regulatory statute presenting the tasks of securing compliance which by its very size make private actions indispensable. The necessity for regulation of the Securities Exchange Act of 1934 is stated in the broadest terms. In section 2, Congress declared that "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto." Another goal of the statute there stated is to make the regulation and control of securities transactions "reasonably complete and effective." The securities of thousands of publicly held corporations are traded in large volume each day on securities exchanges. Literally millions of transactions occur involving thousands of buyers and sellers and shareholders located throughout the United States and foreign countries. A large volume of proxy statements are processed through the Commission on the basis of which mergers, consolidations, dissolutions, sales of assets, and other corporate transactions affecting thousands of shareholders are effectuated. It is manifestly impossible for the Commission by itself to secure adequate compliance with the statute and its proxy regulations.

In addition to the magnitude of the task is the difficult nature of the problem. We here deal with false and misleading statements. The Commission must of necessity rely primarily on documents presented to it and the self-

serving assertions of those seeking approval. There is neither the time, and certainly there are not the resources available to the Commission to adequately investigate the numerous applications for approval of proxy statements submitted to it. Indeed, in many cases (as here), only an intensive and extensive discovery process can reveal the full extent of misrepresentation. As to the existing burden on the Commission, see its testimony before a subcommittee of the House Committee on Internal and Foreign Commerce, 87th Congress, 1st Session, Vol. 3, p. 8, quoted by Commission Chairman William L. Cary, The Special Study of Securities Markets of the SEC, 62 Mich. L. Rev. 557 at 558, 559 (Feb. 1964).

The existence of the private remedy serves a two-fold purpose. On the one hand, it is an ancillary remedy which serves to secure additional compliance; on the other hand, its existence acts as a deterrent to non-compliance. The private remedy to be effective must be one in which appropriate relief may be granted. Only a remedy of this character is consistent with a statute as broadly based as is the Securities Exchange Act of 1934, and which requires "regulation and control reasonably complete and effective," (§ 2; 78 U.S.C.A. § 78b).

Second. The Securities Exchange Act of 1934, and particularly the proxy provisions thereof, are designed to protect shareholders in publicly held corporations as a class.[1] The violation of proxy rules is a violation of duties imposed for the protection of shareholders. Shareholders should have an effective remedy to protect them against wrongs to them growing out of such violations. As stated in *Goldstein* v. *Groesbeck*, 142 F. 2d 422, 427 (C. A. 2, 1944), cert. denied, 323 U. S. 737, (holding that there was a right of action by stockholders of a registered holding company

1. *Howard* v. *Furst*, 140 F. Supp. 507, 510, n. 4 (S. D. N. Y. 1956).

for violations of the Public Utility Holding Company Act of 1935):

> "* * * a denial of a private right of action to those for whose ultimate profection the legislation is intended leaves legislation highly publicized as in the public interest in fact sadly wanting, and even delusive, to that end."

A remedy to be meaningful must extend beyond that of securing an injunction. In the short interval which usually elapses between the issuance of a proxy statement and the shareholders' meeting, there is insufficient time to study the proxy statement, secure counsel and ferret out the facts. The courts will not impose such an impossible burden upon those who seek relief from fraud.

More unrealistic is the suggestion (*Dann* v. *Studebaker-Packard Corp.*, 288 F. 2d 201 (C. A. 6, 1961), that relief be limited to securing a declaration of rights in the federal court and that thereafter a separate state court action be brought based upon such declaration. Such a procedure would defeat the purposes of the Act and make a mockery of the federal judicial process. The "horrors of split or piece-meal litigation" (*Ibid* at 214) include a prohibitive increase in time and expense of litigation. The *Dann* formula assumes that there will be a convenient state forum in which a plaintiff can again obtain personal jurisdiction over the defendants against whom he seeks to enforce a declaratory judgment. The serious roadblock to recovery is the fact that security transactions and particularly proxy solicitations are typically interstate in character, that officers and directors reside (as here; R. 180) in numerous states, and that problems of venue and of service may render impractical any state court action. The impossibility in many situations of securing jurisdiction over the persons of defendants make essential a federal remedy in which all necessary relief may be given. Finally,

a plaintiff forced into one or more state courts faces the likelihood of appeals to the appellate court or supreme courts of each of those states, in order to vindicate federal rights.

Third. Courts will imply a remedy where regulatory legislation has created new duties unknown or rare in the states. The only law regulating the solicitation of proxies is the Securities Exchange Act of 1934, except to the extent that state courts apply non-statutory fraud remedies. The ordinary principles of common law fraud do not impose burdens of affirmative disclosure. Under a variety of statutes where new duties have been created, courts have implied a federal cause of action even where no general grant of jurisdiction is included in the statute. Thus in *Steele* v. *Louisville & Nashville RR Co.*, 323 U. S. 192 (1944), this Court held that there was an implied federal remedy to a railroad employee growing out of the failure of the collective bargaining representative to perform the duty imposed upon it by the Railway Labor Act to represent him without discrimination because of race. Despite the absence of a jurisdictional grant, such as section 27 of the Act the Court not only recognized the right of a private cause of action, but also the right to complete relief.

> "We conclude that the duty which the statute imposes on a union representative of a craft to represent the interests of all its members stands on no different footing and that the statute contemplates resort to the usual judicial remedies of injunction and award of damages when appropriate for breach of that duty." (323 U. S. 192, 207.)

Similarly, see *Fitzgerald* v. *Pan American World Airways*, 229 F. 2d 499 (C. A. 2, 1956), and *Wills* v. *Trans World Airlines*, 200 F. Supp. 360 (S. D. Calif., 1960 (discrimination in violation of Civil Aeronautics Act); and *Reitmaster*

v. *Reitmaster*, 162 F. 2d 691 (C. A. 2, 1947) (wiretapping in violation of Communications Act).

The Act creates a new "federal law of management-stockholder relationships" and "provides stockholders with a potent weapon for enforcement of many fiduciary duties." *McClure* v. *Borne Chemical Company*, 292 F. 2d 824 at 834 (C. A. 3, 1961), cert. denied 368 U. S. 939.

Reasoning from the grant of jurisdiction under § 301(a) of the Labor Management Relations Act (29 U. S. C. A. § 185(a)), this Court has directed federal courts to develop a body of federal substantive law governing collective bargaining agreements, including the specific performance of such agreements.[1]

Fourth. The interstate character of public securities transactions require uniform remedies. Section 2 of the Act clearly expresses the Congressional policy favoring uniformity in the regulation of securities transactions. Uniformity may be best achieved by recognition of a private cause of action in the federal courts, and would be destroyed if injured shareholders were relegated to the state courts. It is undoubtedly for this reason that Congress provided in section 27 of the Securities Exchange Act of 1934 that federal courts shall have exclusive jurisdiction of violations of the Act and the rules and regulations thereunder and "of all suits in equity and actions involved brought to enforce any liability or duty created by this title or the duties and regulations thereunder." This language is wholly consistent with the court's granting all appropriate relief.

1. See, e.g. *Textile Workers* v. *Lincoln Mills*, 353 U. S. 448 at 456-7 (1957); and cases impiementing this decision, such as *United Steelworkers* v. *American Mfg. Co.*, 363 U. S. 564 (1960); *Smith* v. *Evening News Assoc.*, 371 U. S. 195 (1962); *Humphrey* v. *Moore*, 375 U. S. 335 (1964) (Preliminary Print); *Carey* v. *Westinghouse Electric Corp.*, 375 U. S. 261 (1964) (Preliminary Print).

and distinguish the numerous authorities relied on by the Court of Appeals that an implied right of action exists under section 27 for violation of section 10(b) and that complete relief may be given in such actions. Indeed, defendants state that no exception can be taken to these authorities. (Pet., 13). The defendants offer no argument as to why damages or other retrospective relief should be available to a shareholder under section 27 for violation of section 10(b) but not for violation of section 14(a). No effort is made to deal with that portion of the Court of Appeals' decision analogizing the section 10(b) actions with section 14(a) actions.

Jacobson v. New York, New Haven and Hartford Ry. Co., 206 F. 2d 153 (C. A. 1, 1953) *affirmed per curiam*, 347 U. S. 909 (1954) (Case 12-13) is wholly inapposite for here even the defendants concede that federal jurisdiction exists to vindicate § 14(a) violations.[1] The formula developed by the courts in refusing to recognize a private cause of action in relation to the Federal Safety Appliance Act is to a large extent based on the relationship between that act and the Federal Employers Liability Act and the availability of adequate state remedies. As we have noted above the case for implication is strong where state remedies are ineffective or inadequate in practice or where there is need for uniformity and when, as here, there is no comparable duty imposed by state law. These considerations do not apply to situations such as that involved in injuries

1. *Jacobson* was decided principally on the basis of a diversity of citizenship question: where the plaintiff is a resident of Massachusetts and the defendant a corporation incorporated under the laws of both Massachusetts and Connecticut, does diversity jurisdiction exist? *Jacobson* answered the question "No", relying upon a prior decision. The case was affirmed *per curiam* by this Court as defendants point out (Case 13); but the ground of the affirmance was strictly based upon the diversity of citizenship question and not the safety appliance question. The citations set out by this Court in the *per curiam* affirmance relate to the former point, not to the latter.

to workers where the states do offer redress by well recognized remedies. The extensive trial court resources at the state level make unnecessary the creation of a federal remedy. Considerations of this character best justify the Federal Safety Appliance Act's cases which hold that though the Act's safety requirements set the standard of care enforceable by the Government, remedies for injured workers are left to the states which may, if they choose, adopt the federal standards.[1] In addition to the inapplicability of these considerations to the 1934 Act there are important structural differences between that Act and the Federal Safety Appliance Act.[2]

Defendants' reliance on *Nashville Milk Co. v. Carnation Company*, 355 U. S. 373 (1958) (Case 13) is similarly irreconcilable with defendants' concession that a private action may be brought for violations of § 14(a), but in any event is misplaced. In holding that a suit for treble damages and injunction would not lie under the Clayton Act for violation of section 3 of the Robinson-Patman Act, the Court laid stress on the particular structure of federal legislation in the antitrust field, the vagueness of the language used in section 3 and the legislative history of the Robinson-Patman Act.

The defendants place heavy reliance on the maxim *expressio unius est exclusio alterius* (Case 13-15), the argument being that since express private actions are created under sections 9(e), 16(b) and 18(a) of the Act, Congress intended there be no other private remedy. To begin with, defendants are caught up in their own inconsistency. If the maxim is ineffective to bar prospective relief, the defendants having conceded that prospective relief may be

1. Note, Implying Civil Remedies from Federal Regulatory Statutes, 77 Harv. L. Rev. 285, 292 (1963).

2. Loss, *op. cit.*, p. 993, and note also his statement that the Federal Safety Appliance Act cases are *sui generis*.

granted both in section 10(b) and section 14(a) actions, how can it rise to bar retrospective relief?

This Court seemingly laid the maxim to rest with respect to the federal securities laws when it said as to the 1933 Act:

> "Some rules of statutory construction come down to us from sources that were hostile toward the legislative process itself and thought it generally wise to restrict the operation of an act to its narrowest permissible compass. However well these rules may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy." (*S. E. C.* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344, 350-1 (1943).)

Moreover the specific argument raised by defendants has been repeatedly rejected by the courts. See *Baird* v. *Franklin*; 141 F. 2d 238 at 245 (C. A. 2, 1944); *Fratt* v. *Robinson*, 203 F. 2d 627 at 632 (C. A. 9, 1953); *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 at 514 (E. D. Pa. 1946); and Loss, *op. cit.*, pp. 937, 943.

Defendants next seek comfort in *Howard* v. *Furst*, 238 F. 2d 790 (C. A. 2, 1956) (Case 14:15). This reliance is misplaced for the Second Circuit stated unequivocally, 238 F. 2d at 793, that it "left open the question of whether and to what extent Section 14(a) may be construed as creating substantive rights in an individual stockholder". In *Howard* a derivative action was brought on behalf of a corporation which had been merged with another corporation. The complaint alleged that shareholder approval had been obtained by a false and misleading proxy statement. The sole question before the Second Circuit was

whether the *corporation* had a right of action under section 14(a). The court, after a review of the Act, concluded that there was nothing to support the view that any substantive rights were created for its benefit. The court, however, points out that the statute authorized the formation by the Commission of rules and regulations "in the public interest or for the protection of investors" (238 F. 2d at 793), a key phrase which supports the decision of the Seventh Circuit below[1]. In any event *Howard* is inapplicable since count 2 states an action for vindication of rights personal to shareholders. We should add the decision in *Howard v. Furst* stands in isolation. It has not been followed and has been questioned by the same and other courts.[2] We come back, however, to the proposition that defendants by conceding that a private cause of action will lie for prospective relief can hardly rely on a decision which would deny any relief.

Defendants seek to distinguish *Bell* v. *Hood, supra*, by making the astounding argument that section 27 is not a "general grant of jurisdiction" but merely a designation of the forum (Case 15). The plain language of section 27 is the best refutation of this absurd argument.[3]

Having asserted the narrow technical arguments we have

1. See also *Baird* v. *Franklin, supra*, 141 F. 2d at 244, note 4 and text thereto.

2. The late Judge Clark stated: "* * * I suspect that someday we shall have to disavow the much criticized case of *Howard* v. *Furst* * * *". *Brown* v. *Bullock*, 294 F. 2d 415, 422 (C. A. 2, 1961) (concurring opinion). See also *Brown* v. *Bullock*, 194 F. Supp. 207, 232-234 (S. D. N. Y. 1961); *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195, 203 (C. A. 5, 1960), cert. denied, 365 U. S. 814.

3. In this connection defendants seriously misrepresent the position of Professor Loss. Far from regarding section 27 as simply concerned with the designation of the forum (Case 15), Professor Loss has written extensively on the implications of the jurisdiction conferred by Section 27. See, for example, his discussion of section 27. Loss, *op. cit.*, pp. 957, 986-999, 1044 and 2005.

just discussed, defendants advance to higher ground with a survey of policy considerations (Case 16-18). It is their *ipse dixit* that "neither justice nor policy reasons favor creation of such a federal action. The creation of a private action would not assist at all in the effective enforcement of § 14(a)." But their statutory analysis supports our position, not theirs. After being informed that the scheme of the statute is to strengthen common-law standards by requiring full disclosure of all material facts in proxy statements, we are then advised that the function of the proxy rules is to aid the Commission. But, we ask, for whose benefit should the Commission be aided? Clearly for the benefit of the shareholders to whom the proxy statement is intended. It is they who suffer loss by reason of a false and misleading document. The powers of the Commission, the criminal sanctions and the other implementing devices mentioned by defendants, vis-a-vis proxy regulation, are designed for the protection of the shareholders to whom the proxy solicitation is addressed. We need look no further for justification for the creation of an effective private remedy under § 14(a).

Again the argument made is at odds with the holding of the District Court sought to be reinstated here by defendants and their admission that such a cause of action will lie for limited relief under § 14(a).

In relation to the foregoing argument defendants refer to *Lapchak* v. *Sisto*, CCH Fed. Secur. L. Rep., Par. 90,721 (S.D. N.Y. 1955) (Case 18). There the district court explicitly recognized that a complaint for violation of § 14(a) stated a claim. But, said the court, a complaint alleging a proxy solicitation to secure an increase in autorized stock followed by an unfair exchange, fails to state such a claim because of lack of causal connection between the proxy statement and the harm, there being no requirement for stockholder approval of the exchange. Since the complaint alleged

the authorization and exchange were part of a single plan, we find it difficult to understand why the court views each in isolation. In any event, the causal connection problem is not present in the case at bar. Defendants' quotation from *Howard* (Case 18) overlooks the fact that the Second Circuit unequivocally left open the question of a shareholder's right to sue under section 14(a). See discussion pp. 34-5, *supra*.

As though the issue before this Court was whether there should be an implied remedy under section 14(a), defendants next urge that affirmance of the decision below will lead this Court into a chamber of horrors. Problems are pictured as coming in thickets; indeed the federal system itself may become debilitated (Case 19). We think that this Court and the other courts in the federal system have demonstrated the stamina to meet and resolve these problems.[1] We do not mean to suggest that the implementation of private remedy for violation of section 14(a) is devoid of problems, but there have already been a host of decisions granting retrospective relief under the Act and none of the specters have emerged.[2]

1. For over 20 years the lower courts have fashioned implied remedies with full relief under various provisions of the Act. The courts have not met any insurmountable problems. For example, in connection with statutes of limitations which defendants think will pose problems (Case 21), see *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C. A. 5, 1960); *Northern Trust Co.* v. *Essaness Theatres Corp.*, 103 F. Supp. 954 (N. D. Ill., 1952) and cf. *Holmberg* v. *Ambrecht*, 327 U. S. 392 (1946). Indeed, such problems that have arisen have been so infrequent and non-compelling that this case is the first case to our knowledge to reach this Court involving private actions under the Act.

2. See, e.g., *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C. A. 5, 1960); *Errion* v. *Connell*, 236 F. 2d 447 (C. A. 9, 1956); *Frait* v. *Robinson*, 203 F. 2d 627 (C. A. 9, 1953); *Baird* v. *Franklin*, 141 F. 2d 238 (C. A. 2, 1944), cert. denied 323 U. S. 737; *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E. D. Pa., 1946); and *Geismar* v. *Bond & Goodwin, Inc.*, 40 F. Supp. 876 (S. D. N. Y. 1941).

We need not stop to expose to the light of day each of the horrors depicted for us by defendants (Case 20-25).[1] A few observations, however, are in order. We question whether the defendants seriously believe that "except as affected by government antitrust suits, the validity of these vital corporate transactions is today entirely determined by state law" (Case 20). Nor should the defendants be overly agitated by the character of the relief which may be granted in this case should the plaintiff prevail. This case is an equity case and the chancellor has broad discretion to apply the relief that is most appropriate under the circumstances.

Defendants express great concern that "in an area which demands great certainty corporate decision-makers would be forced to work without any guidelines to actions." The guidelines that are relevant to this case are the proxy rules and a high standard of business ethics. As stated recently by this Court:

> "A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry. As we recently said in a related context, 'It requires but little appreciation . . . of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail in every facet of the securities industry. *Silver* v. *New York Stock Exchange*, 373 U. S. 341, 366.'" *S. E. C.* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 186-87 (1963).

Moreover, in the case at bar, we are not dealing with "unintentional non-compliance" (Case 21) but rather with

1. Most of them are distilled from problems discussed in a scholarly fashion and with no apprehension by Professor Loss. See Loss, *op cit.*, pp. 943-999. Indeed he concludes not only that a private remedy should be implied but that the court should have discretion to give full and complete relief.

wilful and serious violations (R. 179-197). In fashioning relief, in any event, the quality of the wrong goes to discretion, not jurisdiction of the court. See Loss, *op cit.*, p. 962.

Finally, the defendants' over-solicitude about the burden which may be placed upon the Commission by allowing private actions is belied by the position of the Commission in the Court of Appeals below.

Defendants place great reliance upon *Dann* v. *Studebaker-Packard Corporation*, 288 F. 2d 201 (C. A. 6, 1961). The complaint in *Dann* was filed by a stockholder of Studebaker who alleged a false and misleading proxy solicitation. The complaint asked that the court declare void the solicitation as in violation of section 14(a) and grant consequential relief. The trial court dismissed the complaint. The Court of Appeals reversed holding that a cause of action was stated under section 14(a). In a *dictum*, however, it concluded that federal jurisdiction was limited to declaratory relief relating to the validity of the proxies.

It should be observed that *Dann* does not adopt the prospective-retrospective dichotomy urged by Case but rather holds that where, as in *Dann*, diversity of citizenship is lacking, the jurisdiction of the federal court under section 14(a) is limited to a declaration of the invalidity of the proxies. In truth, Case concedes its position is wrong for the declaration allowed by *Dann* is but a first step toward retrospective relief.

The Court of Appeals below rejected the *Dann* rationale, pointing out at 317 F. 2d at 848 that its reliance upon *Gully* v. *First National Bank*, 299 U. S. 109, was misplaced because the holding of this Court in *Gully* was simply that "the case arose under state law, uninfluenced by the fact that a federal statute had a collateral bearing thereon." Further, the Court of Appeals below observed that the

Dann court "in its reasoning failed to distinguish between the question of jurisdiction and the question upon the merits of the case whether the plaintiffs were entitled to the relief which they sought. See, concurring opinion, Miller, C.J., 288 F. 2d at 217, 218." (317 F. 2d at 848.)

Every commentary that we have been able to find has been critical of the *dictum* of the *Dann* case.[1]

Defendants argue (Case 23-5 and Indiv. 10-11) at great length that the merger itself is not voidable under § 29(b) and that if it is voidable dire consequences will result. Defendants again overlook their failure to appeal from the order of the District Court holding that there was jurisdiction to declare the merger void under § 29(b) (R. 213). Second, we think the merger agreement is a "contract made in violation of" § 14(a) and hence plainly voidable under § 29(b). Also, since the proxies may be viewed as contracts; they too may be declared void, as defendants concede (Indiv. 10-11). If so, the merger agreement, which required shareholder approval, must also fall.

But this does not mean that as a result of affirming the decision of the Court of Appeals all mergers will be voided "automatically" (Case 23). The complaint here does not expressly seek rescission of the transaction, although the court may grant such relief under the general prayer (R. 197-8). What the complaint does ask is to make whole the class of shareholders represented by plaintiff, either by obtaining money damages or, more equitably, addi-

1. See Loss, op. cit., pp. 2029-32; and the following notes and comments: 3 Boston College Ind. and Comm. L. Rev. 58 (1961); 75 Harv. L. Rev. 637 (1962); 62 Columbia L. Rev. 375 (1962); 40 Texas L. Rev. 405 (1962); 7 Villanova L. Rev. 125 (1961); 9 U.C.L.A. Rev. 232 (1962); and 1962 Duke L. J. 151. See also notes, 112 U. of Pa. L. Rev. 456 (Jan., 1964) and 52 Ill. Bar J. 240 (November, 1963) which criticize *Dann* and speak approvingly of the decision of the Court of Appeals below.

tional securities to compensate for the wrongful dilution of their proportionate interest in the Company (R. 196, 197-8). Again, however, these issues raised by defendants go not to the Chancellor's power but rather to his discretion under the facts and circumstances of each particular case.

The only citation added by the individual defendants is *Brouk* v. *Managed Funds, Inc.*, 286 F. 2d 901 (C. A. 8, 1961) (Indiv. 8). The information is supplied that certiorari was granted, 366 U. S. 958 (1961). What is not stated is that the decision was vacated by this Court as moot. *Managed Funds, Inc.* v. *Brouk*, 369 U. S. 424 (1962).

The Court of Appeals' decision is consistent with a long line of authority. The existence of a private cause of action for violation of the Act has been recognized by every circuit which has considered the question.[1] With the exception of *Dann* discussed above, the right of the plaintiff to appropriate relief has never been questioned. A private right of action for violation of the proxy rules with jurisdiction and discretion to grant full relief is required both by the purpose of the Act and its design.

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1. As to decisions under § 14(a), see cases cited note 1, p. 22, *supra*. As to § 10(b) see: *Ellis* v. *Carter*, 291 F. 2d 270 (C. A. 9, 1961); *Matheson* v. *Armbrast*, 284 F. 2d 670 (C. A. 9, 1960), cert. denied, 365 U. S. 870; *Hooper* v. *Mountain States Securities Corp.*, 282 F. 2d 195 (C. A. 5, 1960), cert. denied, 365 U. S. 814; *Reed* v. *Riddle Airlines*, 266 F. 2d 314 (C. A. 5, 1959); *Fratt* v. *Robinson*, 203 F. 2d 627 (C. A. 9, 1953); *Eason* v. *Connell*, 236 F. 2d 447 (C. A. 9, 1956); *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783 (C. A. 2, 1951); *Slavin* v. *Germantown Fire Ins. Co.*, 174 F. 2d 799 (C. A. 3, 1949); *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512 (E. D. Pa., 1946). As to other sections of the Act see: *Baird* v. *Franklin*, 141 F. 2d 238 (C. A. 2, 1944), cert. denied, 323 U. S. 737 (§ 6(b)); *Remar* v. *Clayton Securities Corp.*, 81 F. Supp. 1014 (D. Mass., 1949) (§ 7(c)); and *Geismer* v. *Bond and Goodwin, Inc.*, 40 F. Supp. 876 (S.D. N.Y., 1941) (§ 29(b)).

PART II.

BRIEF IN RESPONSE TO ISSUES BEYOND THE SCOPE OF THE PETITION FOR CERTIORARI.

II.

THE QUESTION OF THE APPLICABILITY OF THE WISCONSIN SECURITY FOR EXPENSES STATUTE IS NOT PROPERLY BEFORE THIS COURT. IF THE QUESTION IS BEFORE THE COURT: (A) THE STATUTE IS INAPPLICABLE, AND (B) THE STATUTE, IF APPLICABLE, VIOLATES THE DUE PROCESS AND EQUAL PROTECTION CLAUSES OF THE UNITED STATES CONSTITUTION.

In our statement of the question presented (pp. 2-3, *supra*), we have shown that the question of the applicability of the Wisconsin security for expenses statute is not properly before this Court. If the Court should consider the issue, however, our position on the merits is set forth here.

A. The Wisconsin Security for Expenses Statute Is Inapplicable.

The Court of Appeals rejected defendants' argument that count 2 of the complaint is subject to the Wisconsin statute (Case 26-33). It said (317 F. 2d at 849):

> "The court below erred in holding the Wisconsin statute applicable to count 2. *McClure* v. *Borne Chemical Co.*, 3 Cir., 292 F. 2d 824, cert. denied 368 U. S. 939 * * *; *Fielding* v. *Allen*, 2 Cir., 181 F. 2d 163, cert. denied, sub nom. *Ogden Corp.* v. *Fielding*, 340 U. S. 817 * * *."

The decision is correct because the Wisconsin statute applies only to derivative claims (i.e., "in the right of the corporation"). Count 2 states a claim on behalf of shareholders in their own right (i.e., "representative"), not the right of the corporation. The essence of count 2 is that shareholders were deprived of their right to be free from a false and misleading proxy statement and, as a

result, damaged (R. 197). The *Dann* case, upon which defendants rely, makes clear that the right asserted here is that of the shareholders. 288 F. 2d 201, 210-211.

The Court of Appeals held that count 1 of the complaint stated a claim "on behalf of the stockholders individually" (317 F. 2d at 845)[1] and that count 2 alleged by reference "substantially all of the charging paragraphs contained in count 1 * * *" (*Id.* at 846). The rationale of the Court of Appeals that count 1 states an individual claim (317 F. 2d at 841-5) applies with equal force to count 2. Case's argument, that the court "seemed to realize * * * the claim is derivative * * *" (Case 26) expresses defendant's hope, not the court's realization.[2]

Assuming *arguendo*, that count 2 does state a derivative claim, the claim arises from and is bottomed on federal law, and, accordingly the state security for expenses statute is inapplicable. Every court considering the question has so held.

In a lengthy and well reasoned opinion by Chief Judge Biggs, the Court of Appeals for the Third Circuit held that a state security for expenses statute is inapplicable to an action arising under § 10b of the 1934 Act. *McClure* v. *Borne Chemical Co.*, 292 F. 2d 824 (C. A. 3, 1961), cert. denied 368 U. S. 939.

Similarly, in *Fielding* v. *Allen*, 181 F. 2d 163 (C. A. 2, 1950), cert. denied *sub nom. Ogden Corp.* v. *Fielding*, 340 U. S. 817, the court determined that in an action attacking the sale of corporate stock upon the ground that it violated

1. Defendants did not seek review of the decision below as to count 1.

2. If speculation is in order we think it more likely that the Court of Appeals, in citing *McClure* and *Fielding*, *supra*, indicated only that if, *arguendo*, count 2 were derivative, the state statute could still not be applied. We think our assumption is more plausible in view of the Court's holding as to count 1.

provisions of the Interstate Commerce Act, a state security for expenses statute was inapplicable even though the plaintiff there alleged not only federal question jurisdiction but also diversity jurisdiction.

See also *Hoover* v. *Allen*, 180 F. Supp. 263, 267 (S.D.N.Y., 1960); and *Stella* v. *Kaiser*, 81 F. Supp. 807, 808-9 (S.D. N.Y., 1948), both of which hold that state security for expenses statutes are inapplicable to claims grounded on the 1934 Act. "Actions based on federal law are not subject to the state statutes on security for costs." Loss, *op. cit.*, p. 951; and see also 6 Moore's Federal Practice (2nd Ed., 1953), Par. 54.73, p. 1331. Even the District Court's opinion and order hold that the Wisconsin statute cannot be applied to the federally based claim for violation of the Act (R. 209-213); and defendants want that order reinstated (Case 33, Indiv. 13).

Defendants endeavor (Case 29-30) to avoid the impact of *McClure* and *Fielding* by a claim that both of these cases rest upon the decision of this Court in *Payne* v. *Hook*, 7 Wallace 425 (1869). They claim that *Payne* v. *Hook*, holding that the Rules of Decision Act did not apply to equity cases, was overruled by *Mason* v. *United States*, 260 U. S. 545. Hence, they say, *McClure* and *Fielding* fall. The Second and Third Circuits, writing in 1950 and 1961, were perfectly well aware of the 1922 *Mason* decision. What they said was spoken by way of analogy. *McClure* quotes from *Fielding*, making this matter quite explicit:

> "But we think that the policy enunciated in *Payne* v. *Hook*, *supra*, retains its vigor in non-diversity cases. In such cases, if a form of relief exists within the ambit of the federal court's historic equity jurisdiction, it should be available without reference to the peculiar requirements of local law. As Professor Moore puts it: 'Whether equitable relief should be granted and to what extent in federal matters is a matter properly within the domain of federal equity jurisprudence.

> Here, unlike in diversity cases, the federal courts are free of state remedial law,' 2 Moore's Federal Practice (2d ed.), Par. 2.09, p. 456." (292 F. 2d 824 at 833.)

None of the other authorities cited by defendants is in point. The authorities at Case 26-27 relate to classic derivative situations such as waste of corporate assets. They are inapposite here to a claim for violation of stockholders rights by means of a false and misleading proxy statement under § 14(a) of the Act.

Defendants argue (Case 27) it was the corporation rather than the shareholders who were injured if anyone was by the false proxy statement. This contention is made in the teeth of one of defendants' principal authorities, the *Dann* decision, *supra*, 288 F. 2d at 210-211. Defendants also make the unwarranted, if not unconscionable suggestion that plaintiff and the other members of his class can be made whole by having recovery run to the corporation (Case 27). Case would ignore the fact that: (1) for over seven years it has used all of its resources to raise every conceivable legal impediment to block *any* recovery; and (2) the old ATC shareholders as well as the wrongdoing defendants are shareholders of Case and would therefore share in the recovery.

The holding in *Cohen* v. *Beneficial Industrial Loan Company*, 337 U. S. 541 (1949), is limited to diversity actions (Case 28). Recognizing the limitation of *Cohen*, defendants cite *Levitt* v. *Johnson*, CCH Fed. Sec. L. Rep., Par. 91,304 (D. C. Mass. 1963) (Case 29). But that case is inapposite since it involved the application of the "Massachusetts Rule" which bars a derivative action unless it is approved by an independent majority of stockholders. *Levitt* did not involve the question here considered. The Massachusetts district court's reliance on *Housman* v. *Buckley*, 299 F. 2d 696 (C. A. 2, 1962) was misplaced since

in that case jurisdiction was based on diversity of citizenship, not on a federal question. The district court recognized its decision was contrary to *Rogers* v. *American Can Co.*, 305 F. 2d 297, 304, 317 (C. A. 3, 1962) which holds that the right of a shareholder to bring a derivative action for violations of federal (anti-trust) law is to be measured by federal law.

Defendants' weak position is underlined by their citing *Board of Commissioners of Jackson County* v. *United States*, 308 U. S. 343 (1939) (Case 31), a case which supports plaintiff. In *Jackson County* the United States brought suit on behalf of its Indian ward to recover taxes improperly levied on property exempted by treaty. The only issue before the Court was whether the United States was entitled to interest prior to judgment. The Court said (pp. 349-350):

> "* * * The starting point for relief in this case is the Treaty of 1861, exempting M-Ko-Quah-Wah's property from taxation. Effectuation of the exemption is, of course, entirely within congressional control. But Congress has not specifically provided for the present contingency, that is, the nature and extent of relief in case loss is suffered through denial of exemption. It has left such remedial details to judicial implications. Since the origin of the right to be enforced is the Treaty, plainly whatever rule we fashion is ultimately attributable to the Constitution, treaties or statutes of the United States, and does not owe its authority to the lawmaking agencies of Kansas."

The Court held that as a matter of federal law and under the particular circumstances it was not fair to require the state to pay interest. True, in reaching this decision the Court considered state law which permitted interest to no one. But the Court said also (pp. 350-1):

> "Nothing that the state can do will be allowed to destroy the federal right which is to be vindicated; * * * Nor are the federal courts restricted to the remedies available in state courts in enforcing such federal rights. * * * Nor may the right to recover taxes illegally collected from Indians be unduly circumscribed by state law. * * *"

In short, all the federal policy reasons militating for a private right of action with complete relief, which reasons are set forth in Part I above, militate against engrafting "unique and controversial" state statutes that "do not embody traditional principles of law" upon federal laws creating rights for the protection of the investing public at large. *McClure, supra*, 292 F. 2d at 829-835; see also *Sola Electric Company* v. *Jefferson Electric Company*, 317 U. S. 173 at 176 (1942).

B. The Wisconsin Security for Expense Statute, if Applicable, Violates the Due Process and Equal Protection Clauses of the Fourteenth Amendment of the United States Constitution.

The Wisconsin security for expense statute[1] requires that plaintiff be the holder of 3% of the common stock of Case—or 67,883 shares valued at $1,358,000.00—in order to maintain a derivative suit without posting security for defendants' expenses, including attorney fees. The statute differs substantially from the other type of security for expense statute found in New Jersey and a few other states, in failing to provide an alternative standard based on a fixed and reasonable dollar amount of stock ownership. Its effect is to nullify the derivative action as to publicly held Wisconsin corporations.

1. The statute is set forth at Case 3.

This Court sustained the New Jersey security for expense statute (exempting shareholders owning 5% of the stock *or* stock having a market value of $50,000), *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U. S. 541 (1949), but has never passed upon the validity of a statute like Wisconsin's. *Gaudiosi* v. *Mellon*, 269 F. 2d 873 (C. A. 3, 1959), cert. denied 361 U. S. 902, distinguished and discussed below, upheld the Pennsylvania statute, the only statute similar to Wisconsin's. We think the significant distinction between the Wisconsin and the New Jersey type statute renders the former violative of the Due Process and Equal Protection clauses of the Federal Constitution.[1]

The only practical check on management's abuse of the corporation is the derivative suit. See, *Cohen*, *supra*, 337 U. S. 541, 548; and, in addition to the articles collected in *McClure*, *supra*, 292 F. 2d at 829, see Zlinkoff, The American Investor and the Constitutionality of Section 61-B of the N. Y. General Corporation Law, 54 Yale L. J. 352 (1945).

Because of real or fancied abuses of the derivative suit in the form of "strike" suits and "secret settlements," the security for expense statute evolved in New York in 1944. Whether there was any real abuse in New York when that statute was enacted is debatable (see *McClure*, *supra*, 292 F. 2d at 829) but it is clear that strike suits were no problem in Wisconsin when the latter statute was adopted in 1945. See 1948 Wis. L. Rev. 580, 586. Perhaps the most telling criticism of this legislation is, "Had the legislators really been concerned with the so-called 'abuse' of stockholders' suits, the extortionate secret settlement, the remedy was painfully obvious: to bar secret settlements." Hornstein, New Aspects of Stockholders' Derivative Suits, 47 Colum. L. Rev. 1, 3 (1947).

1. It doubtlessly violates the Wisconsin Constitution also but since the state courts have not decided its validity that question may not be passed upon here. *Cohen*, *supra*, at 547.

It was precisely by barring secret settlements that Congress and this Court effectively precluded any possible abuse of the derivative suit in the federal courts. Rule 23(e), Federal Rules of Civil Procedure, forbids dismissal or compromise without approval by the court after notice to the shareholders. Other safeguards against abuse are built into Rule 23(a) and (b). Similar safeguards are afforded in Wisconsin independent of the security for expense provisions. See W. S. A. § 180.405 (1) (2) (3) and 1956 Wis. L. Rev. 322. Thus "strike" suits are unlikely in Wisconsin state or federal courts should this Court invalidate § 180.405(4).

Generally, security for expense statutes provide that shareholders with relatively small holdings may be required to post bond for defendants' expenses, including attorney fees, as a condition precedent to maintaining a derivative suit. The theory is that the derivative suit is most abused by shareholder-plaintiffs who have relatively minor financial interests in the corporation.

The state legislatures have differed in their concept of what constitutes a reasonable minimal financial interest. However, except for Wisconsin and Pennsylvania, all have found that a shareholder with a $50,000 investment has a substantial interest as to whom the statute cannot be applied. The New York Act exempts plaintiffs whose shareholdings amount to 5% of the corporate stock *or* have a market value of $50,000 (N. Y. Gen. Corp. Law § 61-b). The New Jersey statute provides for the same alternative exemptions as New York—5% *or* $50,000 (N. J. S. Anno., § 14:3-15). The Maryland and North Dakota statutes also have exemptions in the alternative but the market value necessary to render the statute inapplicable is only $25,000 (Md. Rule of Procedure, Rule 328, § b (1961); N. D. Century Code Anno., (1960), § 10-19-48). The California statute does not depend on financial in-

terest; it may be applied only where the court finds after hearing that there is no reasonable probability the action will benefit the corporation or that the party seeking security did not participate in the transaction complained of (Calif. Corp. Code § 834).

Only the Wisconsin and Pennsylvania acts fail to provide an alternative exemption based on reasonable market value (W. S. A. § 180.405(4); Penna. Stat. Anno. (Purdon), Title 12, § 1322).

As applied here, the Wisconsin statute requires plaintiff to own 3% of the Case common stock (outstanding at the time of the merger) or 67,883 shares. At the time the district court first held the statute applicable and required security of $75,000 (R. 536), the market value of 67,883 shares of Case common stock was about $1,358,000. In contrast, plaintiff's 2,000 shares were then worth about $40,000. Under the Maryland and North Dakota statutory tests of financial interest plaintiff would have been exempted. Under the New York and New Jersey acts, plaintiff would have been close to the market value exemption and if only one other shareholder with 500 shares joined the action, security could not be required.

The uncontrovertible fact is that no shareholder may bring a derivative action on behalf of Case under the test of financial interest laid down by the Wisconsin statute. The list of shareholders of Case as of October 16, 1956 (the record date for voting on the merger) shows that there were more than 6,700 shareholders of record located all over the United States and in some foreign countries. No shareholder owned more than 67,883 shares except Merrill, Lynch, Pierce, Fenner & Beane, a broker on the New York stock exchange, which held 125,803 shares in its name for customers. The deposition of this brokerage firm showed, however, that of the beneficial owners of

these shares only one owned 2,000 shares and only twenty-four shareholders owned from 1,000 to 1,999 shares. The remaining shares were all owned in lots of less than 1,000 shares. (See deposition of Thomas Meehan taken June 13, 1957, filed May 1, 1958, pp. 2 ff. Ex. 29 (213-238).[1]

Apart from stockbrokers on the New York Stock Exchange, the stockholders' list shows that only 42 shareholders of record held stock in lots of 2,000 or more. Plaintiff, with 2,000 shares, was therefore one of the largest stockholders in the company.

Even the combined "financial interest" of all the Case directors and officers—31,043 shares of common stock worth about $620,000, would not meet the statutory test (R. 34).

It is, of course, common knowledge that the shares of publicly held corporations are widely distributed. A 1941 TNEC study showed that 86% of the total shareholdings of common stock were distributed in lots of 100 shares or less (*Granby*, TNEC Rep., Survey of Shareholdings in 1,710 corporations with Securities Listed on a National Securities Exchange, Monograph 39 (1941); cited in Zlinkoff, The American Investor and the Constitutionality of Section 61-b, 54 Yale L. J. 352, 368 (1945).) As we have shown, Case shareholdings are also widely distributed. There is also no doubt that the Wisconsin statute if applied to other publicly held Wisconsin corporations would require shareholdings of enormous and insurmountable proportions. A random sample of the value of a 3% holding in Wisconsin corporations indicates a range of $223,000

1. The second largest shareholder was Francis I. DuPont & Co., also a broker on the New York Stock Exchange. Of the 61,209 shares it held for beneficial owners, only two beneficial owners held 2,000 share lots and only ten beneficial owners held shares in lots of 1,000 to 1,999. (See deposition of Douglas Graham taken June 11, 1957, filed May 1, 1958, pp. 16 ff. Exs. 9, 11.)

to $3,466,000 (as of 1955 market prices). See 1956 Wis. L. Rev. 322, 325.

The conclusion is therefore inescapable that the Wisconsin statute effectively and completely closes the courts to derivative suits brought by shareholders of publicly held Wisconsin corporations generally and Case particularly, regardless of whether the action is well founded or the shareholder has a substantial financial interest in the corporation. See also 1948 Wis. L. Rev. 580, 593. Nor is there any alternative remedy available to bring directors to account for wrongdoing to the corporation (except as here where the wrong is to the shareholders who may bring a representative action). Without the derivative suit "there would be little practical check on such abuses." *Cohen, supra*, 337 U. S. 541, 548.

While the states may constitutionally impose limitations on the bringing of derivative suits based on alternative financial tests—i.e., percentage of stock *or* reasonable market value, as in *Cohen, supra*, 337 U. S. 541, they are not free to impose arbitrary and unreasonable impediments, so as to foreclose the only existing remedy. The requirement that plaintiff own 67,883 shares of Case common stock worth $1,358,000 in order to maintain a derivative action to hold directors for breach of fiduciary duty to their corporation is arbitrary and capricious and a denial of due process and equal protection of the law.

The essence of procedural due process is that a litigant may not be deprived of his rights without legal process. "Whether acting through its judiciary or through its legislature, a State may not deprive a person of all existing remedies for the enforcement of a right, which the State has no power to destroy, unless there is, or was, afforded to him some real opportunity to protect it." *Brinkerhoff-Faris Trust and S. Co.* v. *Hill*, 281 U. S. 673, 682

(1930) (refusal to permit plaintiff to enjoin tax collector where no other remedy available held a denial of due process). The Wisconsin statute effectively closes the courts to derivative suits—the only means by which the right of the corporation may be protected by shareholders from wrongdoing directors—and affords no "real" alternative. It plainly denies due process of law.

Firmly engrained in substantive due process and equal protection is the principle that the courts "should be open to all persons who in good faith and upon probable cause believe that they have suffered wrongs" (*In re Keenan's Will*, 188 Wis. 163, 205 N. W. 1001, 1006 (1925), and that a person shall not be denied (or receive) justice in relation to the size of his pocketbook. *Griffin* v. *Illinois*, 351 U. S. 12 (1956) (failure to afford indigent prisoner a free trial transcript so as to effectively cut off right to appellate review violates Fourteenth Amendment); *Labowe* v. *Balthazor*, 180 Wis. 419, 193 N. W. 244 (1923) (invalidated statute requiring advance payment of jury fee of $24.00 in order to obtain trial by jury).

If a state may not say that "all men possessed of a certain wealth" shall be subject to attorney fees of parties successfully suing them [*Gulf, Colorado & Santa Fe Ry. Co.* v. *Ellis*, 165 U. S. 150, 155 (1897) (holding invalid a statute imposing attorney fees of up to $10 against carriers who refused to pay small claims)], it may not say that the "poor" shall indemnify the "rich" for attorney fees.

If "There can be no equal justice where the kind of trial a man gets depends on the amount of money he has . . .," [*Griffin* v. *Illinois*, 351 U. S. 12, 19 (1956)], there can be none when he can get no trial at all.

Assuming, as is doubtful (see 1948 Wis. L. Rev. 580, 586), that the "strike" suit was or is really a problem in Wisconsin and that this statute was designed to meet that

problem, since the effect of the statute is to bar all derivative suits on behalf of publicly held corporations, it bears no reasonable relationship to the evil sought to be remedied. Even the Revision Committee Note (1953) to W. S. A., § 180.405 recognized that the statute bears no relation whatever to its supposed object:

> "* * * The problem in the shareholder's derivative action is the possibility of its abuse for personal profit. *This possibility bears no relation to the number of shares held by the plaintiff or his ability to furnish security for expenses.* * * *" (Emphasis supplied.)

Here, as in *Royster Guano Co.* v. *Virginia*, 253 U. S. 412, 416 (1920),

> "* * * It is obvious that the ground of difference upon which the discrimination is rested has no fair or substantial relation to the proper object sought to be accomplished by the legislation. * * *"

See also *Quaker City Cab Co.* v. *Pennsylvania*, 277 U. S. 389 (1928).

For the foregoing reasons we think the Wisconsin statute, as applied here, requiring as it does a plaintiff to own 67,883 shares of Case common stock worth $1,358,000 in order to maintain a derivative suit without posting security for defendant's attorneys' fees, is violative of the Fourteenth Amendment of the United States Constitution.

As stated above, the Pennsylvania security for expense statute, similar to the Wisconsin statute in that it provides no alternative market value exemption, was held constitutional in *Gaudiosi* v. *Mellon*, 269 F. 2d 873 (C. A. 3, 1959) cert. denied 361 U. S. 902. In that opinion, which dealt with a number of other issues, there is scant discussion of the constitutional issue and the opinion does not consider the significant distinction between the Pennsylvania-Wisconsin type statute and the New York-New Jersey type

statute. The court's total statement on the issue is (page 878): "Plaintiff's contention that the Pennsylvania statute providing for security for expenses in derivative actions is unconstitutional ignores our implicit holding to the contrary in *Knapp* v. *Bankers Securities Corp.*, 230 F. 2d 717, and *Murdock* v. *Follansbee Steel Corp.*, 213 F. 2d 570." In the *Knapp* case the court held only that the statute was inapplicable to an action seeking declaration of dividends. In the *Murdock* case the court held only that a beneficial owner of 5% or more of the shares of the stock of the corporation was not subject to the security statute. Under ordinary canons of consfruction we do not see anything "implicit" as to constitutionality in holdings that the statute is inapplicable on the facts.

The Supreme Court of Pennsylvania in a more recent decision, *Reifsnyder* v. *Pittsburgh Outdoor Adv. Co.*, 405 Pa. 144, 173 A. 2d 319 (1961), had before it the alleged inapplicability and invalidity of the Pennsylvania statute. The court held, however, that a minority shareholder action to prevent the dilution of his own votes was a direct or representative action by the shareholder as to which the security statute could not be applied. It therefore found it unnecessary to pass on the constitutionality of the statute but, it should be noted, did not mention that the act had been previously upheld under the Federal Constitution in *Gaudiosi* v. *Mellon* and stated further, as do we, that there are "significant distinctions between the Pennsylvania and New York statutes" (173 A. 2d 319, 320, note 1).

The Wisconsin statute is unconstitutional and, if the issue is reached by this Court, should be stricken down.

CONCLUSION.

The decision of the Court of Appeals with respect to count 2 of the complaint should be affirmed.

Respectfully submitted,

ALEX ELSON,
Counsel for Respondent.

ALEX ELSON,
WILLARD J. LASSERS,
AARON S. WOLFF,
11 S. LaSalle Street,
Chicago 3, Illinois,
ARNOLD I. SHURE,
11 S. LaSalle Street,
Chicago 3, Illinois,
BRUNO V. BITKER,
208 E. Wisconsin Avenue,
Milwaukee, Wisconsin,
Attorneys for Respondent.

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APPENDIX.

Securities Exchange Act of 1934, §§ 2 and 28(a), 15 U. S. C. §§ 78b, 78bb(a).

§ 78b. Necessity for Regulation (§ 2).

For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions:

(1) Such transactions (a) are carried on in large volume by the public generally and in large part originate outside the States in which the exchanges and over-the-counter markets are located and/or are effected by means of the mails and instrumentalities of interstate commerce; (b) constitute an important part of the current of interstate commerce; (c) involve in large part the securities of issuers engaged in interstate commerce; (d) involve the use of credit, directly affect the financing of trade, industry, and transportation in interstate commerce, and directly affect and influence the volume of interstate commerce; and affect the national credit.

(2) The prices established and offered in such transactions are generally disseminated and quoted throughout the United States and foreign countries and constitute a basis for determining and establishing the prices at which securities are bought and sold, the amount of certain taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and the value of collateral for bank loans.

(3) Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities which (a) cause alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce, (b) hinder the proper appraisal of the value of securities and thus prevent a fair calculation of taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and (c) prevent the fair valuation of collateral for bank loans and/or obstruct the effective operation of the national banking system and Federal Reserve System.

(4) National emergencies, which produce widespread unemployment and the dislocation of trade, transportation and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets, and to meet such emergencies the Federal Government is put to such great expense as to burden the national credit.

§ 78bb(a). Effect on Existing Law (§ 28(a)).

(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

United States Constitution, Amendment 14, § 1.

* * * No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.